1962 ANNUAL REPORT

RAPID-AMERICAN CORPORATION

RAPID-AMERICAN CORPORATION

Annual Report

FOR THE YEAR ENDED JANUARY 31, 1963

RAPID-AMERICAN CORPORATION

DIRECTORS

*James Heller
Bernard Kobrovsky
Leonard C. Lane
Samuel J. Levy
Alfred T. Manacher
Samuel Neaman
*Meshulam Riklis
*Lorence A. Silverberg
Murray J. Toussie
Melvin Unterman
*Harry H. Wachtel
*Jacob S. Weinstein

**Member of Executive Committee*

OFFICERS

Meshulam Riklis . . .	*Chairman of the Board & President*
Harry H. Wachtel . .	*Vice Chairman of the Board & Executive Vice President*
Samuel Neaman . . .	*Executive Vice President*
Jacob S. Weinstein . .	*Chairman of Executive Committee*
Isidore A. Becker . . .	*Vice President & Treasurer*
Joseph B. Russell . .	*Secretary*

GENERAL COUNSEL
Wachtel & Michaelson, New York, N. Y.

AUDITORS
Haskins & Sells, New York, N. Y.

TRANSFER AGENT
Chemical Bank New York Trust Company, New York, N. Y.

REGISTRAR
The Chase Manhattan Bank, New York, N. Y.

LISTINGS
American Stock Exchange (Common Stock & Debentures)
Cincinnati Stock Exchange (Common Stock)

EXECUTIVE OFFICES
711 Fifth Avenue, New York 22, N. Y.

DIVISIONS

AMERICAN ART WORKS
Coshocton, Ohio

CELLU-CRAFT PRODUCTS DIVISION
New Hyde Park, N. Y.

ASSOCIATE FASHION INDUSTRIES
New York, N. Y.

CITRUS PRODUCTS DIVISION
Orlando, Fla.

HARRIS STANDARD PAINT COMPANY
Tampa, Fla.

THE RAPID ELECTROTYPE COMPANY
New York, N. Y.

To Our Shareholders:

The year ended January 31, 1963 saw the achievement of a major goal set for Rapid-American Corporation a scant three years ago —majority ownership of McCrory Corporation. In the month of October 1962 this ownership was obtained. We firmly believe that McCrory's operating results and prospects will amply support management's decision.

The annual report of McCrory Corporation for 1962, a copy of which is being sent to all shareholders of Rapid-American, bears this out. As noted therein, McCrory's operating earnings increased 15 per cent on a sales gain of 3.1 per cent which established a new volume peak.

On consolidated sales of $258,175,239 Rapid-American's consolidated operating earnings were $1,257,302, representing 62¢ per share on the basis of 2,035,854 common shares outstanding. No comparison with prior operating results can be made because McCrory's operations were consolidated only for the period since October 1, 1962. The Company sustained non-recurring special losses attributable principally to the liquidation of L & C Mayers' mail order operation, which special loss (net of other consolidated gains) aggregated $3,831,888. In addition, the Company wrote down by $4,500,000 certain notes receivable due from APS Paper Corp. These non-recurring consolidated net special losses aggregated $8,331,888.

1962 was the first full year of operations of all of McCrory's major units: Lerner Shops (a popular-priced women's and children's wear chain); McCrory-McLellan-Green and Cassels (variety stores); National Shirt Shops (a popular-priced men's and boys' clothing and haberdashery chain); and Otasco-Economy Auto Stores (a home and auto supply chain). On net sales of $554,000,000, McCrory earned $5,373,000, after deducting a minority interest of $150,000; these earnings include $1,561,000 of special gain arising from the sale of real estate, and based on 5,279,082 shares of its Common Stock outstanding at December 31, 1962 represent earnings of 76 cents per share of Common Stock (after $1,380,000 of preferred and preference dividends).

A reconstruction of McCrory's 1961 results to include all its major units for the full year, when compared with 1962, shows the following (exclusive of special gains):

	1961	1962	Net Change
Net Sales	$538,000,000	$554,000,000	+ 3.1%
Operating earnings	$ 3,340,000	$ 3,820,000	+15 %

Another significant measure of the progress and health of McCrory is its cash earnings, defined as net earnings plus depreciation and amortization. For 1962, McCrory's operations generated $14,000,000 of cash earnings, equivalent to $2.40 per share of Common Stock (exclusive of special gains and after preferred and preference dividends).

McCrory's strong financial position was maintained; at December 31, 1962 its cash aggregated $21,000,000; current assets of $135,890,000 less current liabilities of $60,709,000, resulted in working capital of $75,200,000, a vigorous 2.2 to 1 ratio; long-term debt was reduced to $62,873,000; and its net worth was $120,860,000, or $18.23 per common share.

Particular attention is directed to the profitable performance of each of McCrory's four units, the details of which are set forth in its annual report. We look ahead confidently to

continued increases in sales, profits and cash earnings.

Rapid-American's operating divisions, commented upon briefly below, presently consist of the following:

(1) Citrus Products Division
(2) Harris Standard Paint Company
(3) Associate Fashion Industries
(4) Cellu-Craft Products Division
(5) The Rapid Electrotype Company
(6) American Art Works

Our Citrus Products Division, acquired in November 1961, made its budgeted contribution to the profits of the Company last year. Sales and profits of the Harris Standard Paint Company, acquired in May 1962, have lived up to our expectations fully. Our Children's Wear Division (now known as Associate Fashion Industries) likewise operated profitably for the entire year.

The Cellu-Craft Products Division, on increased sales, made a substantial profit contribution. It is expected that the consolidation of operations of the Rapid Electrotype Company, noted below, will reverse last year's loss. Drastic economies have been effected in the American Art Works Division, which had a disappointing year.

During 1962, Rapid-American embarked upon the painful but vitally necessary process of pruning those of its operations which proved unable to yield an appropriate return on invested capital. Thus it was reluctantly but firmly concluded that both the Alan Jay-Clarolyte Division and the American Merchandising Division should no longer be retained. The former, which manufactured and marketed sundry plastic toys and novelties, was disposed of by the sale of its assets in September 1962, and the latter, which was in the retail catalog mail order business, ceased operations in January 1963; its inventory has been liquidated and its mailing lists have been leased. Management was convinced that this non-recurring liquidation loss would eliminate with finality the possibility of further operating losses.

The Detroit plant of the Rapid Electrotype Company was sold in January 1963, and the Cincinnati plant was closed. In both cases, profitable national accounts were retained and are being serviced by the Division's three remaining plants in New York, Philadelphia and San Francisco.

We were fortunate in securing the services of Samuel Neaman last year as Vice President in charge of operations for the Company's various Divisions. Mr. Neaman has held a number of responsible executive positions in different industries, both here and abroad. He was promoted to Executive Vice President and elected to the Board of Directors toward the close of the year.

With our liquidation losses behind us, we look forward to 1963 with confidence. We shall expect all our Divisions not merely to operate profitably—always a basic task—but to yield an appropriate return on invested capital, as well, and our intensive efforts will be directed now to finding and applying the best techniques for obtaining a maximum return on our shareholders' dollars.

Respectfully submitted,

M. Riklis

MESHULAM RIKLIS
Chairman of the Board and President

RAPID-AMERICAN

CONSOLIDATED

ASSETS

CURRENT ASSETS:		
Cash		$ 16,048,942
Accounts and notes receivable:		
Trade	$ 8,067,957	
Equity in installment accounts sold (the uncollected balances of which amount to $21,559,944)	3,621,536	
Other, including $4,000,000 notes receivable from unconsolidated subsidiary—(Notes 9 and 18)	6,965,597	
	18,655,090	
Less reserves	1,737,553	16,917,537
Inventories—at lower of cost or market—(Note 13)		107,245,166
Prepaid expenses, etc.		3,307,993
Mortgage receivable—(Note 10)		1,696,000
TOTAL CURRENT ASSETS		145,215,638
INVESTMENTS—At cost		599,916
PROPERTY, PLANT, EQUIPMENT AND LEASEHOLD		
IMPROVEMENTS—At cost—(Note 10)	171,209,759	
Less accumulated depreciation and amortization	80,772,053	
	90,437,706	
Excess of cost of investment in subsidiaries over underlying net equity at date of acquisition; less accumulated amortization	2,263,858	92,701,564
OTHER ASSETS AND DEFERRED CHARGES:		
Excess of purchase cost of 1,263,617 shares (97% ownership) of Lerner Stores Corporation common stock over underlying net equity at dates of acquisition, not at this date assigned to specific assets acquired—(Note 11)	17,056,634	
Notes receivable (non-current portion)—(Note 4)	2,151,365	
Unamortized debt discount and expenses	9,653,655	
Net equity in subsidiary not consolidated—(Notes 9 and 18)	1,232,390	
Goodwill, less amortization of $227,575	1,125,053	
Mortgages and sundry receivables—(Note 10)	2,475,286	
Deferred development expenses—(Note 5)	535,989	
Other	1,379,216	35,609,588
TOTAL		$274,126,706

See notes to financial statements.

CORPORATION AND SUBSIDIARIES (NOTE 1)

BALANCE SHEET JANUARY 31, 1963

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable		$ 34,930,590
Notes payable to banks		21,584,425
Current maturities of long-term debt—(Notes 6 and 12)		3,523,705
Accrued liabilities:		
Federal income taxes		3,051,667
Other taxes		5,115,899
Salaries, wages, commissions, etc.		4,269,442
Interest		1,656,329
TOTAL CURRENT LIABILITIES		74,132,057
LONG-TERM DEBT—Less current liabilities—(Notes 6 and 12)		102,628,096
DEFERRED LIABILITIES:		
Deferred Federal income taxes	$ 3,411,000	
Other	2,033,559	5,444,559
MINORITY INTEREST IN SUBSIDIARY COMPANIES		73,623,262
SHAREHOLDERS' EQUITY (per accompanying statement):		
5% cumulative preferred stock, $100 par value per share, redeemable at $105 per share; authorized 200,000 shares—none issued		
Common stock — authorized 10,000,000 shares of $1 par value per share; issued 2,075,905; less stock in treasury 40,051 shares; outstanding 2,035,854 shares—(Notes 6 and 7)	2,035,854	
Capital surplus	13,806,394	
Earned surplus—(Note 6)	2,934,607	
	18,776,855	
Less equity in subsidiary's cost of its treasury stock	478,123	18,298,732
TOTAL		$274,126,706

See notes to financial statements.

RAPID-AMERICAN CORPORATION

AND SUBSIDIARIES (NOTE 1)

STATEMENT OF CONSOLIDATED INCOME

FOR THE YEAR ENDED JANUARY 31, 1963

NET SALES		$258,175,239
DIVIDENDS RECEIVED FROM McCRORY CORPORATION PRIOR TO OCTOBER 1, 1962		1,268,562
RENTALS, INTEREST AND SUNDRY INCOME—Net		1,070,378
		260,514,179
COST OF GOODS SOLD, RENT, ETC.		185,400,079
		75,114,100
DEDUCT:		
Operating, selling, general and administrative expenses	$55,587,757	
Interest charges	4,203,849	
Depreciation and amortization	3,714,263	
Taxes other than Federal income taxes	5,209,606	68,715,475
INCOME BEFORE FEDERAL INCOME TAXES AND EQUITY APPLICABLE TO SHARES OF SUBSIDIARIES IN HANDS OF THE PUBLIC		6,398,625
PROVISION FOR FEDERAL INCOME TAXES		2,869,027
INCOME BEFORE EQUITY APPLICABLE TO SHARES OF SUBSIDIARIES IN HANDS OF THE PUBLIC		3,529,598
EQUITY APPLICABLE TO SHARES OF SUBSIDIARIES IN HANDS OF THE PUBLIC		2,272,296
NET INCOME APPLICABLE TO SHAREHOLDERS OF RAPID-AMERICAN CORPORATION		1,257,302
SPECIAL ITEMS (LOSS):		
Loss on liquidation of certain operating units—(Note 3)	(4,829,131)	
Write-down of certain accounts and notes receivable to estimated realizable value—(Note 4)	(4,500,000)	
Gain on sale of store properties, excluding minority stockholders' equity—(Note 10)	782,768	
Other—net	214,475	
TOTAL SPECIAL ITEMS		(8,331,888)
NET INCOME AND SPECIAL ITEMS (LOSS) APPLICABLE TO SHAREHOLDERS OF RAPID-AMERICAN CORPORATION		$ (7,074,586)

See notes to financial statements.

RAPID-AMERICAN CORPORATION

AND SUBSIDIARIES (NOTE 1)

STATEMENT OF SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED JANUARY 31, 1963

	TOTAL	OUTSTANDING COMMON STOCK	CAPITAL SURPLUS	EARNED SURPLUS
BALANCE, FEBRUARY 1, 1962	$27,522,897	$2,053,107	$14,392,275	$11,077,515
ADD (DEDUCT):				
Net income and special items (loss) per accompanying statement of consolidated income	(7,074,586)			(7,074,586)
Cash dividends paid, $.50 per share . . .	(1,024,837)			(1,024,837)
Stock issued under employee plans — 12,163 shares; par value credited to common stock account; excess of proceeds over par value credited to capital surplus	155,388	12,163	143,225	
Treasury stock acquired—31,232 shares; par value treated as a reduction of common stock; excess of cost over par value charged to capital surplus	(831,191)	(31,232)	(799,959)	
Other—net	29,184	1,816	70,853	(43,485)
	18,776,855	$2,035,854	$13,806,394	$ 2,934,607
Equity in subsidiary's cost of its treasury stock	(478,123)			
BALANCE, JANUARY 31, 1963	$18,298,732			

See notes to financial statements.

ACCOUNTANTS' OPINIONS

RAPID-AMERICAN CORPORATION:

We have examined the consolidated balance sheet of Rapid-American Corporation and subsidiaries (excluding McCrory Corporation and subsidiary companies) as of January 31, 1963 and the related statements of consolidated income and shareholders' equity for the periods of one year or less then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. In our opinion, the financial statements and their notes examined by us present fairly the financial position of Rapid-American Corporation and subsidiaries (excluding McCrory Corporation and subsidiary companies) at January 31, 1963 and the results of their operations for the indicated periods then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The accompanying financial statements of Rapid-American Corporation and subsidiaries present the consolidation of the above-mentioned financial statements examined by us with those of McCrory Corporation and subsidiary companies examined by Messrs. Arthur Andersen & Co., whose opinion appears below. The total assets of McCrory Corporation and subsidiary companies included in such consolidated financial statements approximate 91% of the consolidated total, and their sales for the four months ended January 31, 1963 approximate 85% of the consolidated yearly total. We have checked the compilation of such accompanying consolidated financial statements and notes and, in our opinion, these have been properly compiled.

New York, N. Y.
April 26, 1963

HASKINS & SELLS
Certified Public Accountants

TO THE BOARD OF DIRECTORS OF McCRORY CORPORATION:

We have examined the consolidated balance sheet of McCrory Corporation (a Delaware corporation) and subsidiary companies as of January 31, 1963, and the related statements of consolidated net income and consolidated surplus for the four months then ended, none of which financial statements is set forth separately herein. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records of the Company and its wholly-owned subsidiaries and such other auditing procedures as we considered necessary in the circumstances. The financial statements of Lerner Stores Corporation, whose net assets represent approximately 35% of the total net assets included in the consolidated financial statements, were not examined by us, but we were furnished with reports of other public accountants thereon.

In our opinion, based upon our examination and upon the reports of other public accountants referred to above, the above described consolidated balance sheet and the related statements of consolidated net income and consolidated surplus present fairly the financial position of McCrory Corporation and subsidiary companies as of January 31, 1963, and the results of their operations for the four months then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

New York, N. Y.
April 19, 1963.

ARTHUR ANDERSEN & CO.

NOTES TO FINANCIAL STATEMENTS

1. Rapid—Principles of consolidation:

The Rapid consolidated financial statements include the accounts of Rapid and its operating subsidiaries. The accounts of units acquired during the year have been included for the periods indicated below:

(a) Harris Standard Paint Company since acquisition of all its common stock as of April 30, 1962 (on July 31, 1962 it was liquidated into Rapid). In April 1963 Rapid entered into an agreement whereby as of April 30, 1963 the properties of Harris are to be sold at book value to McCrory.

(b) Playwell Sport Togs, Inc. since acquisition of all of its common stock as of May 1, 1962 (on June 1, 1962 it was merged into L. & C. Mayers Co., Incorporated, a subsidiary).

(c) McCrory Corporation and subsidiary companies since September 30, 1962 (the acquisition of a little more than 50% of McCrory's common stock was completed early in October 1962).

(d) By acquisition of net assets—operated as parts of divisions:
Coombs Manufacturing Co., Inc. and Gaye Manufacturing Co., Inc. as of February 1, 1962.
Color Wrap Division of Pentron Electronics Corporation as of April 1, 1962.

The Rapid statement of consolidated income includes the operations of the foregoing units commencing with said dates. Such operations resulted in net sales of $223,374,412 and net income applicable to shareholders of Rapid of $2,354,326.

2. Rapid—Sales of properties:

In September 1962 a subsidiary sold substantially all the assets and business of its Alan Jay-Clarolyte Division. In January 1963 Rapid sold substantially all the assets and business of the Detroit plant of the Rapid Electrotype Division and subsequent to January 31, 1963 Rapid sold its investment in Gustave Rubner, Inc., a subsidiary, and realized a nominal loss thereon. Operations of the foregoing units included in the accompanying financial statements resulted in net sales of approximately $2,319,000 and net income of approximately $56,000. The net loss resulting from the above-mentioned sales has been reflected in special items—other in the accompanying statement of consolidated income.

3. Rapid—Loss on liquidation of divisions, etc.:

During the year Rapid substantially completed liquidation of its mail order business and the Cincinnati plant of the Rapid Electrotype Division. Rapid's investment in the remaining assets of these units has been written down to estimated net realizable value at January 31, 1963 and provision has also been made for estimated future liabilities in connection with the completion of the liquidations.

4. Rapid—Receivables from APS Paper Corp.:

As of January 31, 1961, Rapid completed the sale of the assets and business of its American Paper Specialty Division to APS Paper Corp. (a corporation organized by and owned in part by former officers and employees of Rapid). At January 31, 1963 Rapid held $6,750,000 of notes receivable relating to such sale and other receivables of $42,340 due from APS Paper Corp. These notes and accounts receivable are stated at estimated realizable values in the accompanying balance sheet.

5. Rapid—Deferred development expenses:

Deferred development expenses include net expenses of $480,401 of the Laminex Division of Rapid incurred during a period ended in July 1962 when such Division attained commercial production. These costs are being amortized on a straight-line basis over a period of seven years commencing August 1, 1962.

6. Rapid—Long-term debt:

Long-term debt at January 31, 1963 consisted of the following:

7% sinking fund subordinated debentures due November 15, 1967, less debentures in treasury, $120 (a) . . .	$ 2,250,584
5¾% convertible subordinated debentures due January 1, 1977 (b) . . .	13,449,940
4½%-6% notes due 1964 to 1977 (less current maturities $596,359) (c) . . .	24,449,260
	$40,149,784

(a) Rapid is obligated to make annual sinking fund payments (or to deposit principal amounts of reacquired debentures) on each November 15 sufficient to redeem 10% of debenture principal outstanding on the preceding October 31 of the years 1963 through 1966, inclusive. The sinking fund payment due November 15, 1962 was satisfied by the retirement of debentures acquired under the exchange offer outlined in the next paragraph. The sinking fund payments due November 15 of the years 1963 through 1966 will be satisfied out of the remaining $1,976,150 of debentures received in the aforementioned exchange.

On February 20, 1962 Rapid offered to all holders of its 7% Sinking Fund Subordinated Debentures the right to exchange the same for a new issue of 5¾% Convertible Subordinated Debentures, due January 1, 1977. The terms of exchange provided that $80 principal amount of 5¾% Convertible Subordinated Debentures be issued in exchange for each $100 principal amount of 7% debentures tendered for exchange. At completion of offer on May 9, 1962, $2,198,280 principal amount of 7% debentures had been so tendered and $1,758,740 of 5¾% Convertible Subordinated Debentures were issued in exchange therefor. The gain on exchange has been reduced for the portion of unamortized bond discount and expenses attributable to the 7% debentures exchanged and included in special items—other in the accompanying statement of consolidated income.

(b) During the year ended January 31, 1963 Rapid issued $4,082,940 principal amount of the 5¾% Convertible Subordinated Debentures; $1,758,740 in connection with the aforementioned exchange offer, and $2,324,200 were sold for cash and shares of McCrory Corporation common stock.

Rapid is obligated to issue $1,000,000 principal amount of these debentures as of July 1, 1963 (shown as issued in the accompanying consolidated balance sheet), however, such obligation is subject to change under certain circumstances.

The issued debentures are convertible into common stock of Rapid at $33⅓ principal amount of debentures for each share of common stock, subject to anti-dilution provisions of the indenture, and are callable upon notice at principal amount with interest to redemption date.

(c) $23,000,000 of these notes are collateralized by the pledge of 2,661,268 shares of McCrory Corporation common stock which are owned by Rapid. Rapid's investment (eliminated in consolidation) in McCrory common stock at January 31, 1963 aggregated 2,661,268 shares (a little over 50% of the outstanding common stock of McCrory Corporation). The acquisition cost of these shares to Rapid was $46,453,938 and such shares are carried on Rapid's books at $46,803,853 representing Rapid's portion of McCrory common stock equity as of January 31, 1963. Such shares had a market quotation value of $42,912,946 at January 31, 1963.

Agreements covering the indebtedness of Rapid contain various covenants concerning working capital position, additional indebtedness, and various restrictions on transactions in capital stock. Such agreements also contain covenants which limit the declaration and payment of dividends and at January 31, 1963 the consolidated earned surplus of $2,934,607 was available for the payment of dividends.

7. Rapid—Common stock and stock options:

Rapid's shareholders have ratified Restricted Stock Option Plans under which 375,000 shares of Rapid's common stock, including such stock in treasury, are subject to option at prices of not less than 95% of the market value at date of grant, and Employees Stock Purchase Plans under which 45,000 shares of Rapid's common stock are subject to offer at prices of not less than 85% of the market value at date of grant. In accordance with the anti-dilution provisions of the plans, the options have been adjusted to reflect the effect of a three for two stock split in May 1960 and stock dividends of prior years. 150,624 shares of Rapid's common stock have been issued under the foregoing plans through January 31, 1963. Options covering 274,738 shares are outstanding at January 31, 1963, expiration dates are from 1963 to 1970, and option prices per share are from $6.14 to $33.72. The aggregate of the prices for these outstanding options is approximately $6,996,000, and their approximate market quotation value on January 31, 1963 was $4,945,000.

Massachusetts Mutual Life Insurance Company holds purchase warrants entitling it to purchase 25,000 shares of Rapid's common stock at $32 per share at any time before June 1, 1976, and The Ford Foundation holds purchase warrants entitling it to purchase 25,000 shares of Rapid's common stock at $35 per share at any time before June 1, 1976. The terms of these warrants are subject to adjustments under certain circumstances.

8. Rapid—Other matters:

(a) There are several claims pending against Rapid and subsidiaries together with other contingencies. Such liability cannot be determined but management and counsel are of the opinion that the liabilities in the financial statements are adequate to cover all eventual payments.

(b) Rapid and its subsidiaries (except McCrory and subsidiary companies) are obligated directly or contingently under leases expiring after January 31, 1963 for minimum annual rentals of $470,000 and total rental obligations of $3,490,000.

9. McCrory—Principles of consolidation:

The consolidated financial statements as of January 31, 1963, reflect the consolidation of the accounts of Lerner Stores Corporation (whose common stock is 97% owned) and all wholly-owned subsidiaries except McCrory Credit Corporation, which commenced operations in 1962. The net equity of the credit subsidiary not consolidated is stated in the consolidated balance sheet at the amount of McCrory Corporation's investment in the capital of such subsidiary plus net income from commencement of business to January 31, 1963, of which $58,615 is included in McCrory's consolidated net income for the four months ended January 31, 1963. (See Note 18 for additional information on McCrory Credit Corporation.)

Certain items of income and expense included in the consolidated results of operations for McCrory's fiscal year ended December 31, 1962, have been allocated to the extent applicable to the four month period ended January 31, 1963. Such allocations were made generally on the basis of months involved, sales or other factors considered appropriate in the circumstances. Because of the seasonal character of McCrory's business, the resultant net income for the four months ended January 31, 1963, is not representative of operating results on a full fiscal year basis.

10. McCrory—Sale of certain store properties:

During the four months ended January 31, 1963, McCrory Corporation and certain wholly-owned subsidiaries entered into "sale and lease back" arrangements whereby a substantial portion of the companies' store properties and warehouses were sold, at independent appraisal values aggregating $9,856,000 (including $2,080,000 of purchase money mortgages), to subsidiaries of McCrory Corporation's Employees' Retirement Plan. These properties were simultaneously leased back from the purchasers under net leases for a twenty-five year period. The profit on these sales, net of related expenses and Federal income taxes, amounted to $1,560,837, which has been reflected as a special credit carried to earned surplus.

11. McCrory—Excess purchase cost of Lerner Stores Corporation common stock:

During 1961 and 1962, McCrory acquired 1,263,617 shares (97% ownership) of Lerner Stores Corporation common stock, principally as the result of a tender offer made on August 10, 1961. A total of 206,768 of these shares was purchased for $7,341,050 in cash and 1,056,849 shares were acquired in exchange for $42,273,960 face amount of McCrory 5½% Sinking Fund Subordinated Debentures, plus warrants to purchase through March 15, 1976, 1,585,274 shares of McCrory common stock at a price of $20 per share. In accounting for the cost of the Lerner shares acquired in exchange for McCrory securities, the McCrory Board of Directors determined that its debentures be valued at 83% of the face amount of the debentures issued, and the warrants be valued at $5 each. The aggregate cost of the investment in ownership of 97% of Lerner exceeded the McCrory equity in underlying Lerner net assets at dates of acquisition by $17,056,634. This excess purchase cost, which has not at this date been assigned to specific assets acquired, has been recognized by the McCrory management to be similar in nature to intangibles which have not declined in value since date of acquisition. Accordingly, the McCrory management has adopted an accounting policy of not amortizing this excess purchase cost, so long as there is no recognized diminution in value of its investment in Lerner.

12. McCrory—Long-term debt:

Long-term debt at January 31, 1963, including maturities due within one year, consisted of the following:

	Total	Current Maturities	Long-Term Debt
5½% sinking fund subordinated debentures, due 1976 (a)	$36,169,960	$ —	$36,169,960
5.235% subordinated notes due in equal annual installments to 1971	16,076,560	1,786,284	14,290,276
3% sinking fund debentures due in 1967 (b)	4,478,000	78,000	4,400,000
Notes payable to bank (c)	4,000,000	500,000	3,500,000
Mortgages payable	2,605,138	126,062	2,479,076
4% notes due in equal annual installments to 1967	1,665,000	333,000	1,332,000
3¾% notes due in equal annual installments to 1966	411,000	104,000	307,000
	$65,405,658	$2,927,346	$62,478,312

(a) Exclusive of $6,104,000 redeemed ($1,305,000 canceled and $4,799,000 held in treasury, available for sinking fund requirements). Sinking fund requirements in each year (which may be satisfied, through 1967, with the aforesaid debentures held in treasury) are as follows: 1965 and 1966—$1,024,224; 1967 through 1971—$2,048,448; 1972 through 1976—$3,277,517, with a final payment of $12,290,687 due on August 14, 1976.

(b) Exclusive of $522,000 in treasury. Sinking fund requirements are $600,000 in each year to 1966 and $2,600,000 at maturity.

(c) Of the notes payable to bank, $500,000 are due in 1963, with interest at 3¾% per annum, and the balance of $3,500,000 in 1964, with interest at 4% per annum.

The restrictive covenants of the indentures covering the 5½% sinking fund subordinated debentures and the 5.235% subordinated notes payable provide, among other matters, for the maintenance of specified amounts of working capital, as defined, and for certain limitations on indebtedness, as defined, which at January 31, 1963 were as follows:

(a) Consolidated working capital (as defined) must be maintained at least equal to the unpaid principal amount of debentures outstanding, $36,169,960.

(b) Consolidated current assets are required to be 175% of consolidated current liabilities (as defined).

(c) Consolidated indebtedness (as defined) of $48,188,000 should not be in excess of 50% of consolidated net worth.

McCrory Corporation has satisfactorily complied with all of the foregoing requirements at January 31, 1963.

13. McCrory—Merchandise inventories:

Merchandise inventories, stated at the lower of cost or market, consist of the following:

Raw materials, including merchandise at contractors—at specific invoice cost or replacement cost		$ 563,281
Merchandise in transit, at warehouses, and at restaurants—at cost		19,124,284
Merchandise in stores—		
at retail method	$75,690,283	
at first-in, first-out cost	6,613,921	82,304,204
		$101,991,769

14. McCrory—Preferred and preference stock and warrants:

At January 31, 1963, there were 522,947 shares of common stock reserved for the conversion of preferred and preference stock, as follows:

Class of Stock	Redemption Price	January 31, 1963 Conversion Rate Common Shares For Preferred or Preference	Shares of Common Stock Reserved
3½% cumulative convertible preferred	$104	5 for 1	73,955
$6 cumulative convertible preference	115	3/14 for 1	20,330
5½% cumulative preference B	100	6⅙ for 1	72,545
4½% cumulative preference B	100	2 6/7 for 1	356,117
			522,947

In addition, 2,673,467 shares of common stock were reserved for the exercise, at $20 per share, of warrants (expiring in 1976) issued in connection with the 1961 merger of H. L. Green and the 1961 purchase of Lerner stock.

Capital and earned surplus at January 31, 1963 were $39,097,680 and $64,647,555, respectively. Pursuant to certain restrictions in connection with the authorization of preferred stock, capital and earned surplus at January 31, 1963, in the approximate amount of $16,000,000 (including $14,151,555 restricted as the result of purchase of McCrory preference and common stock) are restricted as to future payments of dividends on the common stock or purchase or redemption of shares of stock.

15. McCrory—Stock option and employees' stock purchase plans:

Under McCrory Corporation's restricted stock option plans adopted in 1960 for key employees and officers, 725,000 shares of common stock were reserved for the issuance of options at 95% of the fair market value on the dates of grant, of which options for 649,910 shares were outstanding on September 30, 1962, at prices ranging from $11.88 to $20.90. No options were issued during the four months ended January 31, 1963, and options for 18,000 shares were canceled during this period. Options to purchase 1,990 shares were exercised during the period at an aggregate option price of $24,546. At January 31, 1963, options as to 629,920 shares were outstanding, of which options to purchase 215,940 shares were exercisable; 49,400 shares remained available for future option grants under the plans.

A restricted stock option plan adopted during 1961 authorized the grant to key employees and officers of options to purchase 350,000 shares of common stock at 95% of the fair market value on the dates of grant. Options to purchase 335,250 shares have been issued under this plan (including 12,900 issued in the four month period to January 31, 1963) at prices ranging from $15.44 to $22.80. At January 31, 1963, options as to 318,800 shares were outstanding, none of which were exercisable at that date; 31,200 shares remain available for future option grants under this plan.

Options granted are exercisable for a maximum of ten years. Options generally become exercisable to the extent of 20% each year on and after the anniversary dates of the grants with respect to the 1960 plans, and 20% each year on and after the second anniversary dates of the grants with respect to the 1961 plan. Options may not be sold, transferred, assigned, pledged or disposed of by the optionee except by will or laws of inheritance. In the event of termination of employment by resignation, disability or death, all options will expire within varying periods up to the full term of such options.

Employee stock purchase plans adopted during 1960 (115,000 shares) and 1961 (75,000 shares) permit the grant of rights to purchase a total of 190,000 shares of common stock at 85% of the fair market value thereof on the dates of grant. At September 30, 1962, 75,559 shares subscribed under the 1960 plan were outstanding. Rights to purchase 27,249 shares were exercised, and rights to 480 shares were cancelled during the four months ended January 31, 1963. At January 31, 1963, rights for 39,301 shares were available for subscription, and 47,830 shares were under subscription at prices ranging from $10.63 to $11.48. In January 1963, rights under the 1961 plan were initially offered for subscription and rights for 49,180 of such shares were subscribed.

16. McCrory-Pension plans:

The separate noncontributory retirement plans covering McCrory-McLellan and former Green employees were combined into a single plan to cover eligible employees of the McCrory-McLellan-Green Division, effective January 1, 1962. As under the separate plans, the cost of the continuing plan will be met, as required, by periodic contributions to the successor trust. The amounts accumulated in the trust fund, or previously accrued in the consolidated financial statements in respect of the McCrory-McLellan-Green plan, exceed the actuarial liability as computed by the consulting actuary. For this reason, no provision for costs under this plan was reflected in the statements of consolidated net income since 1960.

Contributions of $175,000, net of Federal income tax benefit, required under the terms of other noncontributory retirement plans and profit sharing plans for employees of Oklahoma Tire and Supply and National Shirt Shops Divisions, and Lerner Stores Corporation, paid or accrued during the four months ended January 31, 1963, have been reflected in the statement of consolidated net income.

17. McCrory—Lease commitments:

At January 31, 1963, the minimum annual rentals upon property leased to McCrory Corporation and its subsidiaries under leases expiring after January 31, 1966, amount to approximately $23,000,000, plus, in certain instances, real estate taxes, insurance, etc.

McCrory Corporation remains contingently liable for the Butler Brothers and Metropolitan Stores liabilities assumed by the respective purchasers of their assets in prior years, including liability for rentals aggregating approximately $28,000,000 at January 31, 1963, under long-term leases expiring 1963-1985, transferred to the purchasers. McCrory Corporation has received from the purchasers valid and enforceable agreements of assumption of liabilities and indemnification in form satisfactory to counsel for McCrory Corporation.

18. McCrory—McCrory Credit Corporation:

McCrory Credit Corporation, a wholly-owned subsidiary of McCrory Corporation, was organized to purchase retail installment sales paper from McCrory and subsidiaries and affiliates. At the end of 1962, McCrory Credit expanded its scope by organizing a separate leasing subsidiary to acquire equipment to be leased to the McCrory-McLellan-Green Division of McCrory Corporation under a 15-year lease agreement dated December 1, 1962.

At January 31, 1963, the Credit Corporation and its subsidiaries had invested $22,400,000 in customers' deferred payment accounts of McCrory and subsidiaries and affiliates and an additional $1,180,000 in equipment purchased for rental. Financing of the foregoing had been provided principally from (1) $1,000,000 of equity funds and $4,000,000 in subordinated short-term loans from McCrory Corporation and subsidiaries, plus (2) $17,900,000 in 4½% bank loans on unsecured notes of the Credit Corporation.

RAPID-AMERICAN CORPORATION

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